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PASS TREASURY (LANGE), FEDERAL RESERVE (KICHLIN)
AND SEC (REILLY)

USOECD

USEEC

E.O. 11652: N/A
TAGS: EFIN, OECD
SUBJECT: MEETING OF OECD COMMITTEE ON FINANCIAL
MARKETS (CFM)

REF: (A) OECD 8167, (B) CFM/A(77)2

1. SUMMARY. CFM SPEND HALF OF TWO-DAY MEETING ON TOUR
D'HORIZON, HIGHLIGHT OF WHICH WAS SWISS PRESENTATION
ON RECENT GENTLEMEN'S AGREEMENT AMONG SWISS BANKS.
"FINANCIAL MARKET TRENDS", A COMPILATION OF DATA AND
COMMENTARY ON INTERNATIONAL AND NATIONAL FINANCIAL
MARKETS PROVIDED FIVE TIMES PER YEAR BY SECRETARIAT,
APPEARED IN ITS PROTOTYPE "NEW STYLE" -- DERESTRICTED,
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PUBLISHED VERSION. CLOSED MEETING WITH BANKERS PRIOR
TO CFM PLENARY WAS LESS INFORMATIVE THAN USUAL. DIS-
CUSSION OF CFM EXERCISE AIMED AT REDUCING IMPEDIMENTS
TO INTERNATIONAL PORTFOLIO FLOWS (US INITIATIVE) MADE
CONSIDERABLE PROGRESS BY CONCLUDING IDENTIFICATION OF
IMPEDIMENTS; IN NEXT STAGE (NOVEMBER MEETING) CFM WILL
TAKE UP QUESTION OF WHETHER AND HOW IMPEDIMENTS CAN BE

REDUCED. SECRETARIAT FLAGGED MCCracken REPORT AS CONTAINING SEVERAL ELEMENTS, MAINLY APPEARING IN THE ANNEX, WHICH MIGHT BE RELEVANT TO CFM'S MANDATE AND COULD BE CONSIDERED FOR THE COMMITTEE'S 1978 WORK PROGRAM. END SUMMARY.

2. CFM MET JUNE 30 AND JULY 1 WITH LIEFRINK (NETHERLANDS) IN CHAIR. CARLISLE (UK) AND THORAND (FRG) ATTENDED FOR LAST TIME.

3. FOLLOWING REPORT ON DEVELOPMENTS IN OTHER PARTS OF OECD AFFECTING CFM'S WORK, WHICH INCLUDED ACCOUNT OF DEVELOPMENT COMMITTEE'S DISCUSSIONS IN MARCH OF LDC ACCESS TO CAPITAL MARKETS, SECRETARIAT SUMMARIZED RECENT MEETING OF GROUP OF FINANCIAL STATISTICIANS (WHICH OVERSEES CONTENT OF FINANCIAL STATISTICS BULLETIN -- THE "GOLD BOOKS"), NOTING THAT FOCUS OF WORK IS NOW SHIFTING TO IMPROVING COMPARABILITY AND TIMELINESS RATHER THAN EXPANDING COVERAGE. SECRETARIAT INVITED ORAL AND WRITTEN COMMENTS ON BULLETIN BY CMF DELS, AND US (KICHLIN) DE THREE RELINISTY OBSERVATIONS: (A) TIME LAG IN MANY SERIES IS EXCESSIVE; B) GREATER ATTENTION TO MORTGAGE MARKETS AND RESIDENTIAL CONSTRUCTION IS DESIRABLE; AND (C) COST OF PROVIDING DATA SHOULD NOT BE IGNORED.

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4. MEETING WITH BANKERS.

THE TRADITIONAL RESTRICTED MEETING WITH PRIVATE BANKERS PRECEDING THE CFM PLENARY WAS LESS INFORMATIVE THAN USUAL. MAIN POINTS, NOT FULLY REFLECTED IN EXPANDED SUMMARY RECORD (FIRST TIME SUCH A WRITTEN SUMMARY PREPARED IMMEDIATELY; COPIES BEING CARRIED TO WASHINGTON BY US DELS AND MAILED TO EUR/RPE) WERE AS FOLLOWS:

-- IN INTERNATIONAL BOND MARKETS, BANKERS EXPECT SHIFT OF EMPHASIS FROM PUBLIC TO PRIVATE ISSUERS, WITH PRIVATE SECTOR ALSO CONTINUING TO ACCOUNT FOR BULK OF PURCHASES;

-- MIDDLE EAST PURCHASERS (THESE ARE MAINLY GOVERNMENT

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AGENCIES) WILL ACCOUNT FOR PERHAPS \$2.5 BILLION IN 1977
(ROUGHLY 10 PERCENT OF TOTAL VOLUME), AFTER BUYING \$1.5
BILLION IN 1975 AND \$2.0 BILLION IN 1976, ACCORDING TO
BANK OF ENGLAND REP;

-- BANKERS SAID THEY ARE HOLDING BACK ON LENDING TO
NON-OIL LDC'S FOR "POLITICAL" REASONS (IN RESPONSE TO
REPORTS IN US PRESS AND RESULTANT STOCKHOLDER CRITICISM)
AND FELT THAT THE IMF AND MULTILATERAL OFFICIAL BANKS
SHOULD STEP INTO THE BREACH (CONCERN WAS EXPRESSED
REGARDING POSSIBLE LIMITATION ON US SUPPORT OF OFFICIAL
INSTITUTIONS' LENDING TO CERTAIN COUNTRIES IN WAKE OF
RECENT CONGRESSIONAL ACTION);

-- BANKERS DID NOT RESPOND TO QUESTIONS CONCERNING
THEIR VIEWS ON COOPERATION WITH IMF AND OTHER INSTITU-
TIONS IN LENDING TO LDC'S; AND

-- SOME BANKERS SUGGESTED THAT OECD COULD PLAY USEFUL
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ROLE IN IMPROVING STATISTICAL DATA ON INTERNATIONAL BOND
MARKET (BIS COLLECTS DATA ONLY ON BANKING TRANSACTIONS).

5. IN PLENARY DISCUSSION OF RESULTS OF BANKERS' MEETING,
SECRETARIAT (HACKETT) SUGGESTED THAT PRIVATE BANKERS MAY

BE EXAGGERATING GROWTH OF CONSTRAINTS ON THEIR LENDING TO LDC'S. SECRETARIAT ALSO POINTED OUT THAT SEVERAL OF LATTER COUNTRIES HAVE RECENTLY COME TO THE MARKET AND ADVANCED SECRETARIAT ESTIMATE THAT TOTAL MEDIUM-TERM SYNDICATED EUROCREDITS TO LDC'S WOULD BE CLOSE TO \$7-9 BILLION IN 1977 (SEE DAF/MC/77.7 OF JUNE 29 WHICH UPDATES SOME DATA CONTAINED IN FINANCIAL MARKET TRENDS NO. "0"). WITH RESPECT TO SUGGESTED NEED FOR IMPROVED INFORMATION ON BOND ISSUES AND REDEMPTIONS, US DEL (LANGE) PROPOSED THAT CFM INSTRUCT SECRETARIAT TO BEGIN WORK TOWARD THIS GOAL (EC REP NOTED THAT COMMISSION HAS DONE SOME WORK WHICH IT WILL SHARE WITH SECRETARIAT).

6. BACKGROUND DOCUMENT FOR CFM'S TOUR D'HORIZON ON NATIONAL AND INTERNATIONAL FINANCIAL MARKETS, "FINANCIAL MARKET TRENDS," APPEARED IN PROTOTYPE "NEW STYLE" FOR PUBLICATION, AS AGREED AT MARCH MEETING (REF A). COPIES OF THIS EDITION NO. "0" ARE BEING MADE AVAILABLE FREE TO VARIOUS FINANCIAL INSTITUTIONS, AND MISSION WILL ENDEAVOR TO OBTAIN FURTHER 25 COPIES FOR WASHINGTON IN ADDITION TO REGULAR DISTRIBUTION TO DELEGATIONS. SECRETARIAT INDICATED THAT COMMENTS ON CONTENT AND FORMAT ARE WELCOME.

7. TOUR D'HORIZON ON NATIONAL FINANCIAL AND FOREIGN EXCHANGE MARKETS: FOLLOWING SUMMARIZES HIGHLIGHTS OF SELECTED PRESENTATIONS BY MAJOR COUNTRIES:

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A) U.S. (KICHLIN) FOCUSED ON DIFFERENCES BETWEEN PRESENT SITUATION AND SIMILAR STAGE OF PREVIOUS ECONOMIC EXPANSIONS -- E.G., MATURITIES OF CONSUMER CREDIT ARE LENGTHENING, MORTGAGE DEBT IS GROWING MORE RAPIDLY THAN VOLUME OF SALES AND NEW CONSTRUCTION WOULD NORMALLY EXPLAIN, MUCH STATE AND LOCAL BORROWING ASSOCIATED WITH ADVANCE REFUNDING, AND RELATIVELY WEAK CORPORATE LOAN DEMAND. THE FIRST TWO PHENOMENA SUGGEST GROWING AWARENESS OF INDIVIDUALS OF FINANCIAL CONSEQUENCES OF INFLATION (MONEY ILLUSION). HIGH LIQUIDITY RATIO IN CORPORATE SECTOR APPEARS TO BE PERMANENT, BUT FIRMS HAVE NOT YET BEEN SUBJECTED TO CONDITIONS WHICH WOULD TEST THIS HYPOTHESIS. THE TREASURY REPAID UNUSUALLY LARGE AMOUNTS IN THE SECOND QUARTER AND MIGHT BE BORROWING ABOUT \$10 BILLION IN THE THIRD AND \$20 BILLION IN THE FOURTH QUARTER; THIS ACCELERATION WOULD SUGGEST SOME UPWARD PRESSURE ON INTEREST RATES LATE THIS YEAR, BUT NOT MUCH UPWARD MOVEMENT IS EXPECTED. IN RESPONSE TO QUESTION BY SWISS DEL (DE RIVAZ) REGARDING INFLUENCE OF US CURRENT ACCOUNT DEFICIT, US INDICATED THAT POLICY

EFFORT TO INFLUENCE INTEREST RATES FOR BALANCE-OF-PAYMENTS PURPOSES SHOULD NOT BE EXPECTED AND THAT RECENT RESEARCH HAS INDICATED ONLY MARGINAL IMPACT OF BALANCE-OF-PAYMENTS SITUATION ON US FINANCIAL MARKETS. AS FOR FUTURE COURSE OF MONETARY AGGREGATES, US DEL SUGGESTED INCREASING LIKELIHOOD THAT FEDERAL RESERVE MAY HAVE TO RESIST A GROWING DEMAND FOR TRANSACTION BALANCES.

B) UK DEL (CARLISLE) EXPRESSED SATISFACTION ON MONETARY

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POLICY SITUATION, TEMPERED WITH CONCERN OVER CONTINUING HIGH LEVEL OF INFLATION AND UNCERTAIN PROSPECTS OF INCOMES AGREEMENT WITH UNIONS. IF PHASE THREE AGREEMENT IS BAD, INTEREST RATES WILL RISE SINCE THE GOVERNMENT IS "KEEN" ON HOLDING TO MONETARY TARGETS; ALSO, INTEREST-RATE POLICY IS NO LONGER ORIENTED JUST TO GROWTH AND EXCHANGE RATE TARGETS. CFM SHOWED CONSIDERABLE INTEREST IN NEW FLOATING RATE GILT-EDGED ISSUES. CARLISLE SAID IT WAS TOO EARLY TO TELL WHETHER THIS EXPERIMENT WAS SUCCESSFUL AND WHAT IMPACT IT MIGHT HAVE ON MONETARY AGGREGATES BUT INDICATED LIKELIHOOD OF ANOTHER SUCH ISSUE. NO INTENTION EXISTS TO PUSH INTEREST RATES ONE WAY OR ANOTHER WITH SUCH ISSUES. QUERIED ON SALE OF BP SHARES, UK DELS FELT THAT PERHAPS ONE-FOURTH TO ONE-

THIRD OF SHARES SOLD MIGHT END UP IN HANDS OF NON-RESIDENTS.

C) FRG DEL (THORAND) INDICATED THAT SLUGGISH CORPORATE LOAN DEMAND AND ROBUST INFLOWS OF TAX REVENUES ARE PRO-LIMITED OFFICIAL USE

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VIDING BASIS FOR SOME DECLINE IN SHORT-TERM INTEREST RATES, BUT THAT LITTLE CHANGE IN MARKETS IS EXPECTED. ECHOING THIS FORECAST, BUNDESBANK REP (KLEIN) ADDED THAT EXTERNAL FACTORS ARE ALSO A BARRIER TO MUCH FURTHER DECLINE IN INTEREST RATES. PUBLIC SECTOR DEFICITS IN 1977 ARE NOW ESTIMATED AT DM 35-37 BILLION (BUND: 21, LAENDER: 11-12, MUNICIPALITIES: 3-4), EXCLUDING SOCIAL SECURITY FUND WHERE DEFICIT IS SWOLLEN BY RECESSION. THE BUND HAS ALREADY FINANCED DM 10 BILLION, AND ITS TOTAL DEFICIT MIGHT DECLINE FROM CURRENT ESTIMATE.

D) SWISS REP (DE RIVAZ) SAID 1977 REAL GNP GROWTH NOW SEEN AT 2.1 PERCENT. HE FELT INTEREST RATES WOULD STABILIZE AND PLACED UPWARD IMPACT OF CREDIT SUISSE AFFAIR AT ONE-FOURTH TO ONE-HALF PERCENT. DE RIVAZ CONSIDERED PRESENT SWISS FRANC RATE TO BE "REASONABLE."

8. DOCUMENT CMF(77)12, ON RECENT FOREIGN EXCHANGE MARKET DEVELOPMENTS, WHILE LISTED ON THE AGENDA, WAS NOT ISSUED, AND THERE WAS NO OBJECTION TO SECRETARIAT'S SUGGESTION THAT CFM MIGHT USEFULLY DISPENSE WITH DISCUSSION OF THIS SUBJECT. (MISSION COMMENT: US APPEARS TO HAVE ACHIEVED ITS GOAL OF LIMITING OR SUPPRESSING EXCHANGES OF VIEWS ON EXCHANGE MARKETS IN THIS FORUM).

9. PART II OF TOUR D'HORIZON -- ON MONETARY POLICY DATA AND BANKING CONTROL -- CENTERED ON SWISS PRESENTATION ON RESPONSE TO CREDIT SUISSE/TICINO DEBACLE. DE RIVAZ (CENTRAL BANK) OUTLINED GENTLEMEN'S AGREEMENT WITH BANKERS WHICH ENTERS INTO FORCE JULY 2, POINTING TO THREE MAIN ELEMENTS:

(A) IDENTIFICATION OF CUSTOMERS;
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(B) PROHIBITION OF ACCEPTANCE OF FUNDS OF DUBIOUS ORIGIN; AND

(C) DENYING ASSISTANCE TO VIOLATION OF OTHER COUNTRIES'
LAWS AGAINST CAPITAL FLIGHT AND TAX EVASION.

DE RIVAZ CHARACTERIZED THE AGREEMENT, WHICH HAD BEEN
UNDER DISCUSSION BEFORE THE CREDIT SUISSE INCIDENT, AS
A CODE OF ETHICS WHICH CARRIES REAL SANCTIONS AND
DIFFERS FROM PREVIOUS PRACTICES IN THAT A COMPLAINT IS
NOT REQUIRED TO TRIGGER INVESTIGATION. HE WILL FORWARD
TO SECRETARIAT TEXTS OF AGREEMENT, WHICH CAN BE EXPECTED
TO BE SUPPLEMENTED IN THE FUTURE. A COMMISSION CREATED
UNDER AGREEMENT WILL LOOK INTO VIOLATIONS AND CAN LEVY
FINES UP TO SF 10 MILLION. FURTHERMORE, BANKS COULD
BE FORCED TO BREAK RELATIONSHIPS WITH CUSTOMERS AND
HAVE LICENSES OF THEIR OFFICERS WITHDRAWN. DE RIVAZ
EMPHASIZED SWISS INTENTION TO "DEMYSTIFY" NUMBERED BANK
ACCOUNTS; THEIR USE WILL BE RETAINED IN VIEW OF COMPUTER-
IZATION OF MOST BANKS' OPERATIONS BUT WILL NOT BE ABLE
TO SERVE AS MEANS OF SHIELDING IDENTIFICATION OF CLIENTS.
THURNHEER (FOREIGN DEPARTMENT) GAVE FEDERAL GOVERNMENT'S
VIEWS, DEPLORING MISCONDUCT BUT STATING THAT THERE IS NO
QUESTION OF ABOLISHING BANK SECRECY LAWS OR OF DISPENSING
WITH REQUIREMENT FOR RECEIPT OF COMPLAINT AND PROOF
OF CRIMINAL INTENT IN COURT

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PROCEEDINGS. HOWEVER, REQUIREMENT IN BANKING LAWS OF "IRREPROACHABLE" BEHAVIOR WILL BE CONSTRUED AS PROHIBITING FOSTERING OF VIOLATIONS OF FOREIGN LAW. THURNHEER NOTED CREDIT SUISSE OWES SF 221 MILLION IN TAXES ON ILLEGAL TRANSACTIONS AND ALSO "NEGATIVE INTEREST RATE" PENALTIES. QUERIED AS TO APPLICABILITY OF GENTLEMEN'S AGREEMENT IN LIECHTENSTEIN, DE RIVAS NOTED THAT THIS COUNTRY DOES NOT FALL UNDER SWISS CURRENCY LAW AND HAS OWN UNIQUE COMPANY LAW; HOWEVER, THERE IS SOME ASSURANCE LIECHTENSTEIN WILL STRENGTHEN ITS SUPERVISORY PRACTICES.

9. IN OTHER COUNTRIES' PRESENTATION, NORWAY SUMMARIZED RECENT AMENDMENTS TO BANKING LAWS AIMED AT "A REAL DEMOCRATIZATION OF THE PRIVATE BANKING SYSTEM" -- SEE CMF (77)18. US (KICHLIN) CALLED ATTENTION PARTICULARLY TO SEVENTH RECOMMENDATION IN SUMMARY OF "REPORT OF THE ADVISORY COMMITTEE ON MONETARY STATISTICS" (CIRCULATED AS CMF(77)15) AND SAID THAT FRB ANTICIPATES UNDERTAKING LIMITED OFFICIAL USE

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A GENERAL REDEFINITION OF MONETARY AGGREGATES (I.E., M-1, M-2, ETC.) WHICH WOULD REFLECT CONCERNS OF ACHIEVING: (A) CONTROLLABILITY; (B) PREDICTABILITY; AND (C) STABILITY OF RELATIONSHIP WITH REAL ECONOMY.

10. STRENGTHENING OF INTERNATIONAL COOPERATION REGARDING PORTFOLIO CAPITAL.

THIS AGENDA ITEM COVERS THE US PROPOSAL PRESENTED AT THE 1976 OECD MINISTERIAL WHICH HAD INITIALLY MET CERTAIN RESISTANCE FROM SOME COUNTRIES. HOWEVER, ALL COUNTRIES COVERED BY US NOTE (CMF(77)1/07) OUTLINING IMPEDIMENTS TO SECURITIES TRANSACTIONS RESPONDED BY TIME OF MEETING WITH WRITTEN AMENDMENTS, EXCEPT FRANCE AND LUXEMBOURG WHICH PROMISED RESPONSES ASAP. ALSO, SWITZERLAND SUBMITTED ITS OWN NOTE (CMF(77)1/19) PARALLELLING US NOTE, OUTLINING IMPEDIMENTS PERCEIVED BY SWISS TO THEIR SECURITIES AND MARKET OPERATIONS IN THE US. CFM AGREED TO SECRETARIAT'S PROPOSAL TO: (A) FINALIZE AND "DENATIONALIZE" MATRIX IN US NOTE SETTING FORTH IMPEDIMENTS TO INTERNATIONAL TRANSACTIONS IN US AND LOCAL SECURITIES IN UK, FRANCE, SWITZERLAND, GERMANY, BELGIUM, NETHERLANDS, LUXEMBOURG, CANADA AND JAPAN (ON BASIS OF AMENDMENTS PRESENTED BY THESE COUNTRIES TO US NOTE AND US REVISIONS THERETO); (B) SEEK COMMENTS FROM THESE AND ANY OTHER INTERESTED COUNTRIES ON PARALLEL SWISS NOTE, ADDING CATEGORIES OF IMPEDIMENTS WHERE THEY EXIST, THEREBY COMPLETING MATRIX (ON ASSUMPTION THAT COUNTRIES

DO NOT DISCRIMINATE AMONG NON-RESIDENTS); AND (C) AT
NOVEMBER MEETING DISCUSS CONCLUSIONS ARISING FROM COM-
PLETED MATRIX AND FURTHER WORK. COMMENTS ON SWISS NOTE
ARE DUE BY SEPTEMBER 30. ACTION REQUESTED: RESPONSE
NO LATER THAN SEPTEMBER 28.
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11. FOLLOW-UP OF EARLIER COUNCIL RECOMMENDATION CONCERN-
ING STANDARD RULES FOR OPERATIONS OF INSTITUTIONS FOR
COLLECTIVE INVESTMENT IN SECURITIES (SEE CMF(77)10).
CFM, NOTING THAT EC IS ABOUT TO PRODUCE DRAFT DIRECTIVE
ON MUTUAL FUND SHARES, AGREED TO SEND A REPORT TO THE
COUNCIL REGARDING COMPLIANCE WITH RECOMMENDATION WITHOUT
FIRST HOLDING A MEETING OF EXPERTS. EC REP REPORTED
ON PROGRESS OF DRAFT DIRECTIVE IN COMMIS-
SION, NOTING THAT IT HAS AN INNOVATIVE CHARACTER AND
THAT ITS ADOPTION IS THUS NOT ASSURED. DIRECTIVE
WOULD BE FIRST EC EFFORT TOWARD LIBERALIZATION OF
CAPITAL FLOWS IN ALMOST 15 YEARS.

12. WORK ON EURO-MONEY AND -CREDIT MARKETS (SECRETARIAT
NOTE CMF(77)16 LISTED ON AGENDA WAS NOT ISSUED).
SECRETARIAT HOPES TO ISSUE DRAFT INTRODUCTION TO FIVE
COUNTRY NOTES (CMF(76)7 SERIES) BY EARLY FALL. CFM
AGREED THAT SECRETARIAT SHOULD ORGANIZE MEETING OF
EXPERTS, PROBABLY IN OCTOBER, TO DISCUSS DRAFT, PERHAPS

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INCLUDING REPS FROM COUNTRIES OTHER THAN THOSE FIVE
WHICH ARE SUBJECT OF NOTE.

13. CONSULTANT REPORT ON INTEREST RATE MARGINS AND
COST OF INTERMEDIATION. SECRETARIAT REPORTED THAT
CONSULTANT (PROF. REVELL) HAS COMPLETED PROCESSING
MASSIVE DATA AND HOPES TO HAVE COMPREHENSIVE DRAFT BY
OCTOBER. A FIRST MEETING OF EXPERTS TO DISCUSS STUDY
MIGHT BE HELD JUST BEFORE CHRISTMAS.

14. PROGRAM OF WORK FOR 1977 AND 1978:

SECRETARIAT ALERTED CFM DELS TO RECENTLY PUBLISHED
MCCRACKEN REPORT AND SAID IT CONTAINED A NUMBER OF
ANALYSES/RECOMMENDATIONS BEARING ON FUNCTIONING OF
FINANCIAL MARKETS WHICH CFM WOULD WISH TO CONSIDER.
NETHERLANDS DEL WILL SUBMIT A NOTE ON POSSIBLE WORK.
STUDIES ON EUROCURRENCY MARKETS IN ANOTHER FOUR OR FIVE
COUNTRIES (SEE PARA 12 ABOVE) WILL BE INITIATED. FURTHER
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WORK ON US PROPOSAL CONCERNING PORTFOLIO FLOWS IS ALSO
ON THE TABLE, AS WELL AS FOLLOW-UP TO VARIOUS COUNCIL
RECOMMENDATIONS CONCERNING SECURITIES MARKETS. SECRE-
TARIAT SAID IT WILL COMMENCE PUBLISHING DATA ON INTER-
NATIONAL BOND ISSUES, WILL WIND UP WORK ON CORPORATE
FINANCE BY CATALOGING OFFICIAL SOURCES, AND WILL EXPLORE
POSSIBILITY OF IMPROVING STATISTICS ON TRANSACTIONS IN
INTERNATIONAL BOND MARKET. FINALLY, SECRETARIAT
SUGGESTED A MORE SYSTEMATIC EFFORT ON BANKING LEGISLA-
TION IN MEMBER COUNTRIES.

15. NEXT MEETING OF CFM IS SCHEDULED FOR NOVEMBER 17
AND 18.
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Message Attributes

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